No. 96-1773

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IN THE

Supreme Court of the United States

October Term, 1996

ASTORIA FEDERAL SAVINGS & LOAN ASSOCIATION,

Petitioner,

-v.-

THE STATE OF NEW YORK and NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE (JAMES J. WETZLER, COMMISSIONER OF TAXATION AND FINANCE) and THE CITY OF NEW YORK,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE NEW YORK SUPREME COURT, APPELLATE DIVISION, SECOND DEPARTMENT

BRIEF OF RESPONDENTS STATE OF NEW YORK AND NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF QUESTION PRESENTED

Whether this Court should grant certiorari to review a decision of the New York Supreme Court, Appellate Division, Second Department, which held under New York law that New York Public Authorities Law § 1045-u(3), as enacted in 1984, did not create an exemption from New York corporate franchise taxes for interest on bonds issued by the New York City Municipal Water Finance Authority, where the decision sought to be reviewed does not involve an important question of federal law.

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STATEMENT OF THE CASE

In 1984, New York State (the "State") enacted legislation (the "Act") creating the New York City Municipal Water Finance Authority (the "Authority"). L. 1984, ch 513. Section 2 of the Act contained New York Public Authorities Law § 1045-o, authorizing the Authority to issue bonds to pay the costs of water projects or for any of its other corporate purposes. New York Public Authorities Law § 1045-o (McKinney Supp 1984) ("Public Authorities Law"). Section 2 of the Act also contained Public Authorities Law § 1045-u, captioned "Exemption from taxes, assessments and certain fees; payments in lieu of taxes." Subdivision 3 of section 1045-u provided:

> 3. Any bonds issued pursuant to this title together with the income therefrom as well as the revenues, moneys and all other property and activities of the authority shall be exempt from all taxes and governmental fees or charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes. The state hereby covenants with the purchasers and with all subsequent holders and transferees of bonds issued by the authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom and all revenues, moneys, and other property pledged to

secure the payment of such bonds shall at all times be free from such taxes, except for transfer and estate taxes.[1]

Petitioner Astoria Federal Savings & Loan Association ("petitioner") is a federal savings and loan association (52, A-5)[2]. Petitioner alleged that it was the owner of the Authority's Water and Sewer System Revenue Bonds, Fiscal 1986 Series A, maturing on June 15, 2015 and bearing interest at a rate of 9.25 percent (the "bonds") (56). The official statement pursuant to which the bonds were marketed and the approving opinion of bond counsel both stated that the interest on the bonds was exempt from federal income taxes and from personal income taxes levied by New York State and its political subdivisions

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[1]Substantially similar language was contained in the New York State Local Water and Sewer Authority Act, L. 1984, ch 510, which enacted New York Public Authorities Law § 1196-l(3), and in the enabling legislation of eleven additional New York public authorities. *See, e.g.*, New York Public Authorities Law § 1020-m (Green Island Power Authority; L. 1986, ch 807); § 1048-u (Buffalo Municipal Water Finance Authority; L. 1985, ch 796); § 1115-t (Albany Municipal Water Finance Authority; L. 1986, ch 868); § 1120-n (Town of Clifton Park Water Authority; L. 1990, ch 724); § 1197-m (Water Authority of Great Neck North; L. 1985, ch 795); § 1198-n (Water Authority of Western Nassau County; L. 1990, ch 868); § 1199-n (Rensselaer County Water and Sewer Authority; L. 1986, ch 723); § 1199-nn (Wayne County Water Authority; L. 1987, ch 685); § 1199-oo (Orange County Water Authority; L. 1987, ch 709); § 1199-nnn (Saratoga County Water Authority; L. 1990, ch 678); § 1226-m (Greater Utica Area Water Purification Finance Authority; L. 1990, ch 730).

[2]Parenthetical citations are to the Record on Appeal in the New York Supreme Court, Appellate Division, Second Department. Parenthetical citations consisting of "A" followed by a page number are to the appendix to the petition for a writ of certiorari.

(64, 133, 192). Neither the official statement nor the bond counsel opinion stated that interest on the bonds was exempt from any New York corporate franchise taxes (64-192). Petitioner initially included such interest in its entire net income for New York State and City franchise tax purposes (239-240, 411, A-5).

During 1990, the respondent New York State Department of Taxation and Finance (the "Department") learned that petitioner's counsel was advising banks that Public Authorities Law § 1045-u(3) exempted interest on the bonds in the hands of financial institutions and other corporations from New York corporate franchise taxes (241-243, 268-269). In response, the Department issued a technical services bulletin, TSB-M-90(14)C, dated December 18, 1990, which advised that interest on the bonds was subject to New York corporate franchise taxation (271-278). Specifically, with respect to banks, the Department advised that interest income on the bonds was included in entire net income for bank franchise tax purposes pursuant to New York Tax Law § 1453(b)(1)(B) (McKinney 1987) ("Tax Law") and that the bonds themselves were included in the computation of taxable assets pursuant to Tax Law § 1455(b)(1) (272). The Department advised that the reference to "franchise taxes" in, among other provisions, Public Authorities Law § 1045-u, referred to and modified the exemption from taxation of activities of the Authority but not the Authority's bonds or the interest on the bonds (271-272). The Department observed that public authority bonds and the interest on such bonds had historically been included in the income and asset measures upon which New York corporate franchise taxes were imposed and that courts had consistently upheld such application of the franchise taxes (273-274).

In 1991, the State amended Public Authorities Law § 1045-u(3) to read as follows:

> Any bonds issued pursuant to this title together with the income therefrom [as well as the] *shall be exempt from taxation except for transfer and estate taxes. The* revenues, moneys and all other property and activities of the authority shall be exempt from all taxes and governmental fees and charges, whether imposed by the state or any municipality including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes [,except for transfer and estate taxes]. The state hereby convenants with the purchasers and with all subsequent holders and transferees of bonds issued by the authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom *shall be free from such taxation, as aforestated herein*, and *that* all revenues, moneys, and other property pledged to secure the payment of such bonds shall at all times be free from such taxes [,except for transfer and estate taxes] *as aforestated herein*. (L. 1991, ch 166, § 26).[3]

The legislature declared that the purpose of the 1991 amendment was "to make it unquestionably clear and reaffirm that" the bonds and the interest on such bonds had always been subject to indirect taxation, including state and local franchise, estate, gift and transfer taxation (285, 305). L. 1991, ch 166, § 22. The

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[3]Material deleted from the original version of § 1045-u(3) has been placed within brackets []; *italicized material* denotes matter added by the amendment. All sections of the Public Authorities Law set forth in note 1, *supra*, were similarly amended. L. 1991, ch 166, §§ 23-36.

1991 amendment was effective retroactive to July 24, 1984, the date of enactment of Public Authorities Law § 1045-u. L. 1991, ch 166, § 406(d)(3).

In 1993, petitioner commenced this action against the State of New York and the Department seeking a judgment declaring, among other things, that Public Authorities Law § 1045-u(3), as orginally enacted in 1984, exempted the interest on the bonds from the calculation of petitioner's franchise tax and that the 1991 amendment of section 1045-u(3) violated the Due Process Clause (Amendment V, XIV) and the Contracts Clause (Article I, § 10, cl 1) of the United States Constitution (51-63). Respondent City of New York (the "City") moved to intervene in this action (23-32) and the motion was granted without opposition (33). Following joinder of issue, petitioner moved for summary judgment (34-50), and the State, the Department and the City cross-moved for summary judgment (203-312 [State and Department], 313-412 [City]).

The New York State Supreme Court denied petitioner's motion for summary judgment and granted respondents' motions in an order dated August 29, 1994 (A-15-A-28). The court declared that Public Authorities Law § 1045-u(3) as originally enacted in 1984 did not exempt the bonds or the income therefrom from inclusion in the capital or income tax bases for purposes of calculating petitioner's State and City corporate franchise tax liability (A-28). Petitioner appealed to the Appellate Division, Second Department (1-2).

On July 8, 1996, the Appellate Division, Second Department affirmed the order of the Supreme Court (A-1-A-14). *Astoria Federal Savings & Loan Association v State of New York*, 222 AD2d 36, 644 NYS2d 926 (2d Dept 1996). The court noted that franchise taxes are excise taxes imposed on corporate entities for

the privilege of carrying on a business in corporate form and that such taxes are indirect rather than direct taxes on a corporation's entire net income. The court stated that a franchise tax is not levied directly on the bond income or the bonds themselves, even though the amount of the tax is determined by the amount of the corporation's entire income, including investment income. The court observed that New York's franchise tax on banking corporations was based on "entire net income", computed without exclusion or deduction of any income from interest on any kind of stock, securities, or indebtedness. Tax Law § 1453(b)(1)(B). The court also relied on *Werner Machine Co. v Director of Division of Taxation*, 350 US 492 (1956), and *Anchor Savings Bank, F.S.B. v Chu*, 117 AD2d 889, 498 NYS2d 898 (3d Dept 1986), in support of its observation that the long-established rule was that interest paid on municipal bonds, although exempt from direct taxation, was not exempt from indirect taxation. Thus, according to the court, such interest was included in the measure of a corporation's entire net income for purposes of calculating its franchise tax obligation, even where the governing statute generally exempted the bond and its income from taxation. The court noted that, as plaintiff conceded, the Legislature had not purported to exempt public authority bond interest from corporate franchise taxes between 1933 and the passage of the Act (45-48).

The court stated that under New York law, a taxpayer claiming any exemption from taxation must establish that clear and unambiguous statutory language creates the entitlement. *Matter of D.S. Alamo Associates v Commissioner of Finance of City of New York*, 71 NY2d 340, 343, 520 NE2d 542, 543-544, 525 NYS2d 823, 825 (1988); *Matter of Mobil Oil Corporation v Finance Administrator of the City of New York*, 58 NY2d 95, 99, 446 NE2d 130, 132, 459 NYS2d 566, 568 (1983). The court concluded that, as originally enacted in 1984, Public Authorities

Law § 1045-u(3) was inartfully drafted and was ambiguous in that, among other things, it appeared to exempt bondholders from the payment of real estate taxes on their bonds and bond interest, which made no sense, and to exempt bonds and bond interest from franchise taxes, even though only corporations paid franchise taxes. The court determined that because of these ambiguities, New York law permitted resort to the legislative history of the Act to determine the Act's true intended meaning. The court found that plaintiff's interpretation of Public Authorities Law § 1045-u(3) creating a franchise tax exemption for the Authority's bond interest would have been an unprecedented departure from over half a century of legislative practice, yet the legislative history was silent regarding such novel tax treatment. The court concluded that under Public Authorities Law § 1045-u(3), only the Authority, not its bonds or bond interest, was intended to be exempt from franchise taxes.

The court found additional support for its construction of Public Authorities Law § 1045-u(3) from the fact that the bonds were not marketed on the basis of the unusual franchise tax exemption claimed by petitioner and that the relevant franchise tax statutes explicitly required that bond interest be included in the calculation of entire net income. Tax Law § 1453(b)(1)(B). The court also pointed out that petitioner's interpretation, exempting Authority bond interest from New York franchise taxation, would cause New York's franchise taxes to be discriminatory within the meaning of 31 USC § 3124(a)(1), which permits only nondiscriminatory state franchise taxation of United States obligations. *See, Memphis Bank & Trust Co. v Garner*, 459 US 392 (1983). The court found that New York law favored a construction of the statute that would preserve its constitutionality. Finally, the court relied upon the New York courts' traditional deference to the Department's interpretations of tax statutes when the interpretations are rational and reason-

able and do not contravene the legislative intent. *See, Matter of Unimax Corporation v Tax Appeals Tribunal*, 79 NY2d 139, 144-145, 589 NE2d 358, 360-361, 581 NYS2d 135, 137-138 (1992).

The court stated that, in view of its determination that Public Authorities Law § 1045-u(3) as originally enacted did not exempt interest on the bonds from petitioner's franchise tax obligations, "we need not address the plaintiff's remaining contentions regarding the 1991 rewriting of Public Authorities Law § 1045-u(3)" (A-12). The court emphasized that the amendment was a clarification rather than a change of the original statute. The court went on to conclude, however, that, even if the 1991 amendment retroactively eliminated a franchise tax exemption, petitioner's due process rights were not violated because the retroactive application to petitioner, who had apparently not initially relied on the exemption, was not harsh and oppressive.

On October 22, 1996, the New York State Court of Appeals dismissed petitioner's appeal from the decision of the Appellate Division, Second Department "upon the ground that no substantial constitutional question is directly involved" (A-29). 88 NY2d 1064, 674 NE2d 337, 651 NYS2d 407. Thereafter, the Court of Appeals denied petitioner's motion for leave to appeal. 89 NY2d 807, 678 NE2d 500, 655 NYS2d 887 (1997).

REASON FOR DENYING THE WRIT

The petition for a writ of certiorari should be denied because it does not involve an important question of federal law. Moreover, the decision below does not conflict with relevant decisions of this Court or with any decision of another state court of last resort or of a United States Court of Appeals. Both the New York Supreme Court and the Appellate Division decisions rested on the conclusion that Public Authorities Law § 1045-u(3) as originally enacted in 1984 did not exempt interest on the bonds from petitioner's entire net income for franchise tax purposes. Accordingly, those courts held that the contract urged by petitioner supposedly promising a continued franchise tax exemption for the bonds simply did not exist. The Court of Appeals dismissed petitioner's appeal for lack of a substantial constitutional question. Although for purposes of Contracts Clause analysis, this Court may decide for itself as a federal question whether a contract existed, this Court accords respectful consideration and great weight to the views of the State's highest court on such questions. There is no reason for this Court to depart from such policy of respectful consideration in this case, where the court below thoroughly considered and rejected petitioner's interpretation of the 1984 version of Public Authorities Law § 1045-u(3).

This Action Does Not Involve an Important Question of Federal Law

The petition for certiorari is based entirely upon petitioner's claim that the 1991 amendment (L. 1991, ch 166) impaired a statutory bond covenant in violation of the Contracts Clause (Article I, § 10, cl 1) and the Due Process Clause (Amendment V, XIV) of the United States Constitution (Petn, 10-14). However, both the Supreme Court and the Appellate Division

interpreted the 1984 version of Public Authorities Law § 1045-u(3) not to have created a franchise tax exemption for interest on the Authority's bonds. Accordingly, those courts determined that the Legislature did not create the covenant in 1984 that petitioner asserts was impaired in 1991, and the Court of Appeals dismissed petitioner's appeal for lack of a substantial constitutional question.

This Court does not ordinarily sit to review state court determinations resting on independent and adequate state grounds, nor does it review federal issues that can have no effect on the state court's judgment. *International Longshoremen's Association, AFL-CIO v Davis*, 476 US 380, 387 (1986); *Zacchini v Scripps - Howard Broadcasting Co.*, 433 US 562, 566 (1977). However, for purposes of Contracts Clause analysis, this Court may decide for itself as a federal question whether a contract existed. *See*, *General Motors Corporation v Romein*, 503 US 181, 187 (1992); *Irving Trust Co. v Day*, 314 US 556, 561-562 (1942). In making such a determination, this Court accords respectful consideration and great weight to the views of the state's highest court. *See*, *General Motors Corporation v Romein*, *supra*; *State of Indiana ex rel. Anderson v Brand*, 303 US 95, 100 (1938); *Guaranty Trust Co. of New York v Blodgett*, 287 US 509, 512 (1933); *Coombes v Getz*, 285 US 434, 441 (1932); *Honeywell, Inc. v Minnesota Life and Health Insurance Guaranty Association*, 110 F3d 547, 552 (8th Cir 1997). Such deference is especially appropriate in this case because the existence of the contract claimed by petitioner depends upon the interpretation of a New York statute. *See*, *e.g.*, *State of Indiana ex rel. Anderson v Brand*, *supra* (existence of contract primarily a question of state law).

In the present case, there is nothing that merits review by this Court. The decision below is consistent with the decisions of

this Court as well as with those of the New York courts. *See, Werner Machine Co. v Director of Division of Taxation*, 350 US 492 (1956) (upholding state corporate franchise tax measured by corporation's "net worth" including federal bonds because the tax was not imposed directly on property, and the measure of the tax could properly include tax-exempt income or property); *Matter of Anchor Savings Bank, F.S.B. v Chu*, 117 AD2d 889 (3d Dept 1986) (holding that bank must include tax-exempt bond interest in net income for franchise tax purposes despite statute providing that the interest "shall at all times be free from taxation"). The court below thoroughly analyzed the actual language of Public Authorities Law § 1045-u(3) and reasonably found that the scope of the franchise tax exemption was ambiguous. The court below reasonably construed the provision based on its legislative history and New York's long history of including tax-exempt bond interest in the corporate franchise tax income and asset tax bases. The lower court's construction of the statute harmonized it with the bank franchise tax statute including such interest in entire net income (Tax Law § 1453[b][1][B]) and also rendered it constitutional under 31 USC § 3124(a)(1). *See, Memphis Bank & Trust Co. v Garner*, 459 US 392 (1983). The court below concluded that no franchise tax exemption contract was created in 1984, thus ending any Contracts Clause inquiry regarding the impact of the 1991 amendment. *See, Guaranty Trust Co. of New York v Blodgett, supra*, (deferring to the state court's construction of an earlier tax act as including the transaction at issue without reference to a subsequent more specific amendment); *Honeywell v Minnesota Life and Health Insurance Guaranty Association, supra*, 110 F3d at 553. Finally, the lower court's analysis in the alternative of petitioner's Due Process Clause claim regarding the 1991 amendment was not necessary to its decision and does not present a reviewable question. Accordingly, the decision below does not involve an important federal question and does not

conflict with any relevant decisions of this Court or with any decision of another state court of last resort or of a United States Court of Appeals. The petition for a writ of certiorari should be denied.

CONCLUSION

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE DENIED.

Dated: Albany, New York
June 3, 1997

Respectfully submitted,

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